No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District,

Appellee.

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REPLY BRIEF FOR APPELLANTS.

INTRODUCTION.

Since appellee has done so, we here repeat, so far as feasible, the headings in our opening brief, following each heading with such comment as is called for by the brief of appellee.

FIRST PROPOSITION: THE RECONSTRUCTION FINANCE CORPORATION IS NOT A CREDITOR AFFECTED BY THE PLAN OF COMPOSITION, AND ITS CONSENT IS NOT ENTITLED TO BE CONSIDERED.

On this point, appellee first says in its brief (pp. 19, 20):

Italics are ours throughout unless otherwise noted.

> "A. The Court found the Bonds are Owned by the RFC and are Outstanding. The Issue is Primarily One of Fact, Not of Law."
>
> "B. The Evidence Sustains the Finding."

Appellee's discussion suggests that there are questions of weight and credibility. In fact, there are none. The evidence concerning the relation between RFC and the petitioner is all documentary, and all undisputed. See our brief, pages 10-24. See, also, the brief of Florence Moore, pages 20-26.

Findings in bankruptcy cases are not binding on appeal, especially where based on documentary evidence, or on inferences from undisputed facts: 6 *Cyc. Fed. Proc.,* Sec. 2989; p. 628, ff; 8 *Remington on Bankruptcy,* p. 233.

1. The documents uniformly speak of the transaction as a loan.

Appellee does not dispute the indisputable fact that throughout the documents constituting the contract between the RFC and petitioner, the RFC's advances are spoken of as a "loan", and the petitioner as the "borrower".

2. The RFC and district have repeatedly acknowledged that the indebtedness of the district to the RFC is the loan, and not the old bonds.

The measure of appellee's answer to this proposition is furnished by the following quotation from its Brief:

> "In some of the letters or documents written by employees of the RFC the old bonds are loosely referred to as 'collateral' or 'security' and the money used to buy old bonds as an 'advance'.
>
> But of course it is of no consequence what phraseology employees or third persons may use in attempting to describe this rather complicated transaction" (Br. Appellee, p. 24).

To the material in our brief (pp. 20-22), we add only the following: A resolution of the *Board of Directors* of petitioner reads in part as follows (R. 377-8):

> "Upon motion of Director Wood, seconded by Director Wolfe, all bills presented were approved and * * * warrant No. 35,288 in favor of the Federal Reserve Bank of San Francisco, *being for interest on money loaned by the Reconstruction Finance Corporation* for the period July 1, 1936 to January 1, 1937, in the sum of $151,889.71 was *ordered paid out of the refunding bond interest fund.*"

3. The fact that the district, with its own funds, participated in payments to bondholders and paid refinancing expenses further shows there is no obligation of the district to the Reconstruction Finance Corporation on the deposited bonds.

Appellee's attempt to meet the proposition stated in the heading appears at its brief, page 39. In answer, we refer to the authorities cited in the brief of Florence Moore (p. 25), which shows the importance of the proposition stated in the heading.

4. The setting up of reserve funds for the RFC also shows a loan arrangement.

Nothing need be added to our brief (p. 23). See also the brief of Florence Moore, pages 24-25.

5. The RFC is not entitled to be recognized as a creditor because it has not filed a claim.

Appellee treats this point at pages 39-40 of its brief. It does not meet the simple fact that the RFC filed no claim. The statute, we submit, forbids taking account of the acceptance of the plan by any creditor who does not file a claim.

The point is developed in our brief, pages 24-25. It is a highly significant fact that the RFC has studiously remained out of this entire proceeding, except for the filing

of its consent to the plan. Even its consent is significantly ambiguous; it does not mention the debt actually owing to it, namely, the loan; it simply recites that the RFC "has purchased and now holds bonds aggregating in principal amount $14,686,000." This statement is perfectly consistent with what (we submit) is clearly the real status of the RFC, namely, that of pledgee.

Pursuant to the statute, on motion of the objecting bondholders, the RFC was directed by the Court to appear at a hearing set to determine whether it is a creditor affected by the plan (R. 139-140). The RFC did not appear.

6. The transaction resulted in a pledge.

We have shown that under California law (which expressly governs, R. 216), the transaction was a pledge of the old bonds and not a purchase thereof by the RFC (our brief, pp. 25-31; brief of Florence Moore, pp. 23-26).

7. The RFC is fully bound to accept refunding bonds.

The fundamental purpose of the "Bond Purchase Contract" (so entitled) was to provide for the purchase of bonds, i. e., refunding bonds. Its central provision reads:

> "* * * the Borrower will issue and sell, and RFC will purchase, not to exceed EIGHT MILLION SIX HUNDRED THOUSAND ($8,600,000) DOLLARS aggregate principal amount of the refunding bonds of the Borrower * * *".

As we have seen, no word in the contract, nor, indeed, in the superseded "agreement", makes the obligation of the RFC to accept refunding bonds conditional upon surrender of all the old bonds by the nonconsenting bondholders.

We cannot set out the documents in full, but a reading thereof shows that by the Bond Purchase Contract, the RFC became bound to purchase refunding bonds in the

maximum amount above-named, and to surrender old bonds in exchange therefor at 51.501 cents on the dollar.

The appellee quotes (in part) a *proviso* in this contract, to the effect that the RFC may, "in its discretion, keep any part of" the old bonds alive, "for any purpose" (Br. Appellee, p. 23).

Appellee thus says in effect that the parties, by their ultimate contract, meant one of two things (but does not clearly say which):

1. "In consideration of the 'loan' of so much, the 'Borrower' agrees to pay either the amount borrowed or approximately twice that amount, as the lender may elect", or

2. "As between ourselves, the RFC must accept refunding bonds in the amount loaned; but as against any holder of old bonds who refuses to surrender them, the parties hereto may assert that the full amount of the old bonds surrendered are an actual debt of the borrower to the RFC."

Neither of these constructions is tenable, for a number of reasons:

1. Both would be illegal, and void for the excess over the actual debt, under the California law, which governs by express provision (Exhibit OO, p. 216). See our brief, pages 25-31, and the brief of Florence Moore, pages 22-26.

2. Both would be grossly usurious, and void for the excess as a penalty. *Cal. Const.,* Art. XX, Sec. 22; 3 *Williston on Contracts* (2d Ed.), Sec. 781; 5 id., Sec. 1407.

3. The second construction would be contrary to the plain language of the contract. This, because there is *not even a suggestion* that the RFC's alleged option to demand double payment shall cease if all of the old bonds are brought in. On the contrary, the RFC's apparent discretion is absolute. Indeed, the clause says so; it says that

if in any way the RFC should "acquire legal title to *all, or any part*" of the old bonds, then "in its discretion" the RFC may keep the old bonds alive "for any purpose" (Exhibit OO, p. 203).

In other words, if the provision in question is taken to give the RFC the right, at its election, to demand full payment of the old bonds, then inescapably the RFC has that power *in any event,* i. e., whether all of the old bonds are surrendered or not. It follows that the second of the two possible constructions for which appellee contends is contradicted by the contract itself.

4. But the first possible construction (set out above), is, in addition to being illegal under California law, simply fantastic, and contrary to common sense.

It is highly significant, therefore, that an alternate and entirely reasonable interpretation of the provision is possible, namely, this:

The parties intended, we submit, to provide by this provision that the RFC's *security rights* in the old bonds shall include the full rights of an owner, up to, and as security for, the amount owing. Although the RFC would probably have those rights as pledgee without express provision, an express provision is nevertheless both natural and desirable, as is shown by the large amount of litigation that arises, in cases of partial refinancing, over this precise question, namely, the question whether one who has made a loan to a debtor on the security of part of an old bond issue may assert, *as security for the loan* the rights of an outright owner of old bonds. See the many cases on the question discussed in 47 *Harvard Law Review,* 1093-1126, and 81 A. L. R. 139-146.

At page 22 of its brief, appellee says:

> "Under this agreement the district agrees to bring about the participation of all the *old* securities in the refinancing plan (Ex. OO, 218)."

Two comments are appropriate:

1. When examined, the actual provision to which appellee refers in this statement is simply an undertaking by the district to *attempt* to bring about the participation of nonconsenting bondholders. Actual participation by nonconsenting bondholders is *not* made a condition, either in form or substance. It does not, therefore, change the pledge to a conditional purchase.

2. The "Agreement" relied upon by appellee was, we submit, superseded and extinguished long before the first disbursement, as we now show.

The contractual documents were as follows:

1. The original RFC resolution (Nov. 14, 1934) (Ex. OO, pp. 155-79);

2. Acceptance thereof by petitioner (Dec. 11, 1934) (Ex. OO, pp. 180-2);

3. An amendment of the RFC resolution (July 6, 1935) (Ex. OO, pp. 192-3);

4. Acceptance thereof by petitioner (July 23, 1935) (Ex. OO, pp. 194-7);

5. An "Agreement" between RFC and the petitioner (Aug. 14, 1935) (Ex. OO, pp. 217-21);

6. The "Bond Purchase Contract" (Sept. 16, 1935) (Ex. OO, pp. 202-17);

7. A second amendment to the original RFC resolution (about Sept. 17, 1935) (Ex. OO, pp. 193-4);

8. Acceptance thereof by petitioner (Sept. 18, 1935) (Ex. OO, pp. 198-201).

The first disbursement by the RFC was on October 4, 1934, when $14,071,000 of old bonds were surrendered (R. 344).

The "Bond Purchase Contract" of September 16, 1935 (number 6, supra), incorporates by reference the original resolution of the RFC and the resolution of petitioner accepting it, i. e., numbers 1 and 2, supra (Ex. OO, p. 213, foot). The "Bond Purchase Contract" also provides as follows (Ex. OO, p. 216):

> "This contract, together with the Resolution of R.F.C. herein referred to, and also the resolution of the Borrower, herein referred to, *contain the entire agreement between the parties* and shall be governed by and construed in accordance with the laws of the State of California."

This provision necessarily, we submit, excludes, and supersedes, the "agreement" of August 14, 1935 (number 5, supra), cited several times and quoted at length by appellee, at pages 22-23, and elsewhere.

Apart from that circumstance, however, as shown above, the "agreement" does not support appellee's statement.

Nowhere in the final contract, i. e., the resolutions referred to and the Bond Purchase Contract, is there so much as an intimation that all the old bonds must be brought under the plan as a condition to the RFC's obligation to exchange the old bonds held by it for refunding bonds.

We lack space to analyze the contract in detail, and must ask the Court to read the documents, which are listed above in order of execution.

8. The Reconstruction Finance Corporation had no authority in law to do other than make a loan to the district, and the district was authorized only to accept a loan.

The only argument of appellee that requires notice (pp. 40-41), is the statement that the RFC is by the statute authorized to make loans "through the purchase of securities". So it is; but one cannot make a loan to a debtor by purchasing its bonds, unless either (a) the bonds are

purchased directly from the debtor, or (b) the bonds are (as we say is the case here), purchased from third parties *for the account of the debtor,* and held by the lender simply *as security* for the loan.

It follows, as shown in our brief, pages 31-34, that purchase of the old bonds by the RFC on its own account, would have been *ultra vires;* and contracts are not construed as so intended.

9. The plan has been fully executed out of Court as to the deposited securities.

Nothing in appellee's brief requires any addition to the discussion of this point in our brief, pages 35-36.

10. The RFC and the district are bound by the proceeding in the State Court.

Appellee (pp. 41-2) ignores the plain intent of the California statute to provide that voluntary acceptance of a plan is election to make a binding contract, and therefore is irrevocable *in any event,* even though the proceeding is later dismissed, or the statute held void. It follows here that the debt of appellee to the RFC was fixed as the amount of its loan, by its voluntary acts in the State proceeding. This apart from all else in the case.

11. No provision in the statute permits debts that have been extinguished to be treated as still existing.

Appellee argues that even though its actual debt to the RFC is simply the amount of the loan, secured by the surrendered old bonds, even so (it argues), the statute permits it to say, as against appellants, that it owes the full amount of the old bonds. The provisions relied on for this startling proposition are these:

> "Any agency of the United States holding securities acquired pursuant to contract with any petitioner under this chapter shall be deemed a creditor in the amount of the full face value thereof" (Sec. 82).

> "The partial completion or execution of any plan of composition as outlined in any petition filed under the terms of this Act by the exchange of new evidences of indebtedness under the plan for evidences of indebtedness covered by the plan, whether such partial completion or execution of such plan of composition occurred before or after the filing of said petition, shall not be construed as limiting or prohibiting the effect of this Act, and the written consent of the holders of any securities outstanding as the result of any such partial completion or execution of any plan of composition shall be included as consenting creditors to such plan of composition in determining the percentage of securities affected by such plan of composition" (Sec. 83(j)).

The brief of Florence Moore (pp. 26-32), shows that these provisions cannot reasonably be construed as appellee contends.

Appellee argues (p. 28) that since Section 83(j) permits any creditor who has taken refunding bonds to consent, it should apply here because refunding bonds are to be issued in the future. There are two answers: (a) Section 83(j) permits consent of the *refunding bonds*, not of the old bonds cancelled by the issuance thereof; (b) it follows by unavoidable implication, that the Congress had no intention of providing that debts extinguished (as here), by partial but permanent action out of Court, may be revived and treated as still existing later on.

No rational purpose would be accomplished by construing the statute as reviving the cancelled debts for any purpose.

This proposition is discussed in the brief of Florence Moore, pages 32-34, where it is shown that nothing would be added to the already ample powers of the RFC to participate in refinancing schemes, by the astonishing an-

nouncement that the Municipal Bankruptcy Act, as quoted above, has the effect that a petitioner owing $10,000,000 may scale down its debts as if it owed $20,000,000.

It is important to observe that if construed as appellee contends, the statute would fictitiously swell the claims of the RFC (and of all governmental agencies), even in cases where the agency frankly admitted (what the RFC has never denied in this case) that it "held" the old securities merely as pledgee, as security for a much smaller debt. Moreover, it would have that effect in *all* proceedings under the act; not merely as against non-consenting bondholders, but as against all other creditors as well. The outrageous consequences are apparent. Appellee's construction is therefore opposed by the fundamental canons of interpretation.

The provision making public agencies creditors for "full face value" is inapplicable, however construed, under the rule against retrospective interpretation.

The proper construction (as above) is, we submit, that the provisions are intended to settle the much-vexed question of the *security* rights of parties participating in a partial refinancing.

The RFC is not the United States Government, nor are its contracts laws. As the Court said in *Continental Ill. Nat. Bank & Tr. Co. v. Chi., R. I. & Pac. Ry. Co.*, 294 U. S. 648, 684, answering the RFC's claim to a special position in a proceeding under Section 77B:

> "The Reconstruction Finance Corporation Act creates a corporation and vests it with designated powers. Its entire stock is subscribed by the government, but it is nonetheless a corporation, limited by its charter and by the general law. The act does not give it greater rights as to the enforcement of its outstanding credits than are enjoyed by other persons or cor-

porations in the event of proceedings under the Bankruptcy Act."

So here, except to the extent that the statute so provides (and up to the time of any such enactment), the RFC's rights are simply those of any other creditor lending money on the security of old bonds.

If the statute were construed as petitioner contends, it would be giving it completely retrospective effect to apply it here, i. e., to say that the debt, which had been owing to the RFC for two years at the time of the enactment, shall (as against other creditors), be doubled.

It is settled that every presumption militates against such a construction, and certainly nothing in the statute expresses, or even suggests, intent that it shall operate retrospectively. To our previous discussion (brief of Florence Moore, pp. 34-36), we add the following:

Hassett v. Welch, 303 U. S. 303:

A Federal Estate Tax subjected to taxation all irrevocable transfers made during decedent's lifetime, where he reserved a life interest. The Court here held this inapplicable to transfers made before the enactment, by one who died after the enactment. The Court said:

> "In view of other settled rules of statutory construction, which teach that a law is presumed, in the absence of clear expression to the contrary, to operate prospectively; * * * we feel bound to hold that the Joint Resolution of 1931 and § 803(a) of the Act of 1932 apply only to transfers with reservation of life income made subsequent to the dates of their adoption respectively."

Miller v. United States, 294 U. S. 435:

The Court here held that a regulation of the Veteran's Bureau that the loss of one hand and one eye constitutes total permanent disability, did not apply to a cause of action existing at the date of the regulation, though the

regulation was in force when action was brought. The Court said:

> "The law is well settled that generally a statute cannot be construed to operate retrospectively unless the legislative intention to that effect unequivocally appears. Twenty per Cent. Cases, 20 Wall. 179, 187, 22 L. ed. 339, 341; Chew Heong v. United States, 112 U. S. 536, 559, 28 L. ed. 770, 778, 5 S. Ct. 255; Fullerton-Krueger Lumber Co. v. Northern P. R. Co., 266 U. S. 435, 437, 69 L. ed. 367, 368, 45 S. Ct. 143. * * * Accordingly, the regulation here involved must be taken to operate prospectively only."

12. Appellee's authorities (in support of its contention that the RFC is a creditor to the full amount of the old bonds held by it), do not support the contention.

Appellee says (pp. 29-37) that in the past,

> "* * * reorganization agencies found it necessary to acquire outstanding securities and hold them at their full face value so as to assure equality among all holders. A long line of cases upholds such practice."

The fact is, however, that the cases then cited are simply not in point. They fall into three groups:

1. Several of them announce the rule that a corporation may acquire its own bonds and pledge them as security. They do *not* hold, however, or even suggest, that the holder of such bonds is a creditor to the full amount thereof. On the contrary, they hold or assume that bonds so held may be enforced only so far as necessary to pay the debt for which they are security. Thus, in

> *Claflin v. South Carolina R. Co.*, 8 Fed. 118 (cited and quoted by appellee at page 31),

the Court said in part (p. 133):

> "Without pursuing this branch of the case further, it is sufficient to say that I am of the opinion that the holders of all bonds now out on pledge by the company are entitled to their proportionate share of the security of the mortgage, *to the extent that may be neces-*

sary to pay the debts for which they are respectively held."

This case as well as

American Brake Shoe & Foundry Co. v. N. Y. Rys. Co., 270 Fed. 261, also cited by appellee,

is discussed in an excellent article on the question of corporations pledging their own bonds, in 47 *Harvard L. Rev.* 1093, 1103-4, 1106-7, quoted below.

Other cases of the same kind cited by appellee are

Fidelity & Columbia Trust Co. v. Louisville Ry. Co., 258 Ky. 817, 81 S. W. (2d) 896;

Slupsky v. Westinghouse, 78 Fed. (2d) 13.

The article in the *Harvard Law Review* just referred to reads in part as follows, and shows that in such cases the creditor is *never allowed to collect more than the actual debt for which the debtor's bonds are held as security:*

"* * * While the giving of one unsecured obligation of a debtor as collateral security for another unsecured obligation seems an obvious anomaly, yet in the absence of any intervening equities of other creditors, such an arrangement may be of some procedural value, since some courts may permit the creditor to bring suit on the collateral rather than on the principal debt. Although only a single satisfaction *not exceeding the amount of the real debt* is allowed in such cases, the creditor's recovery may be expedited if a sealed instrument or a negotiable note secures an unfunded obligation. It is apparent, however, that to permit a claim to be made in any form of insolvency proceeding both on the principal debt and on the pledged unsecured bonds, or on the pledged collateral alone to an amount exceeding the real debt, will run directly afoul of the elementary proscription against double or padded claims. The courts in these cases where additional unsecured bonds or other evidences of indebtedness of the debtor have been pledged as collateral security have seen clearly the vice in a pledge of a debtor's own obligations, and, apparently without ex-

ception, *have uniformly denied a creditor the right to prove a claim upon any but the real debt.*

If the assets of the corporation are not being administered for the benefit of creditors, the pledgee [of mortgage bonds], as in the case of unsecured collateral may pursue its remedy on the pledged bonds and obtain a personal judgment thereon, subject to satisfaction for *only the amount actually owing.* In the event of insolvency proceedings, however, the only proper basis for a deficiency claim *is the amount owing on the actual debt. A claim against general assets based upon the bonds is improper, either in addition to the claim based upon the actual debt or even as an alternative thereto.*

Where a creditor's day of reckoning with a corporation calls for the liquidation of a debt secured by the corporation's own mortgage bonds, the unraveling of the pledgee's rights is not essentially complicated if the vital differentiation between the promissory element of the bonds and the element of the property lien is observed. Undoubtedly, of course, the bonds afford a form of security so far as the proceeds of the mortgaged property are applicable. *But they cannot serve to enlarge beyond the amount of actual indebtedness the basis for the computation of dividends from the general assets.*"

2. Appellee also cites the following cases on this question:

Mowry v. Farmers' Loan & Tr. Co., 76 Fed. 38;

Barry v. Mo. K. & T. Railway Company, 34 Fed. 829, at p. 832;

Ketchum v. Duncan, 96 U. S. 659, 24 L. Ed. 868;

Slupsky v. Westinghouse, 78 Fed. (2d) 13;

Burlington City Loan & T. Co. v. Princeton Lighting Co., 72 N. J. Eq. 891, 67 Atl. 1019 (Nov. 18, 1907).

In fact, these cases announce and apply a wholly irrelevant doctrine, namely this: Where a corporation offers refunding bonds which are not accepted by all of the old

bondholders, and where the old bonds surrendered are not cancelled, but are held as security for the refunding bonds, the holders of the refunding bonds may enforce the lien of the old bonds, on equal terms wtih the non-consenting old bondholders, *so far as and no further than is necessary to satisfy the amount of the refunding bonds.* They hold simply that the *security* behind the old bonds accrues to the benefit of the new bonds.

Three of these five cases are discussed in a note on the question, entitled "Lien of mortgage securing corporate bonds as affected by exchange of bonds for those of reorganized or new corporations" (81 A.L.R. 139). None of these cases even suggests (what appellee contends) that the amount of the old bonds continues as an obligation of the debtor. They hold, on the contrary, that the old bonds survive only as security for the new obligation up to, but not beyond, the amount of the new obligation.

3. One of the cases cited by appellee,

Ketchum v. Duncan, 96 U. S. 659, 24 L. Ed. 868,

concerns still a third situation, not relevant here. In that case the claimant had *not* lent money to the company at all, whether to buy up securities or for any other purpose. He had simply bought up coupons on his own account, to preserve the credit of the company, in which he was interested. The Court said in part:

> "In near prospect of this inability, William B. Duncan, the head of the firm, on the 28th of April, 1874, telegraphed from New York to the company at Mobile that his firm would purchase for their own account sterling coupons, payable in London. The firm also telegraphed to the Bank of Mobile and to the Union Bank of London to purchase the coupons there presented for them, charging their account with the cost, and transmitting the coupons uncanceled. The railroad company acceded to the proposition made

them, and the Bank of Mobile and the Union Bank did also."

The inapplicability of the *Ketchum* case here is brought out strikingly by the fact that the Court approved, but *distinguished* a New York case which *is* in point in the present controversy, namely,

Union Tr. Co. of N. Y. v. Monticello & Port Jer. R.R. Co., 63 N. Y. 311.

Missouri K. & T. R. Co. v. Union Trust Co., 156 N. Y. 592, 51 N. E. 309, held (concerning an issue of bonds a small part of which was callable each year by lot) that the debtor, which had itself acquired most of the bonds, could not call the remainder immediately, but was bound to follow the method for calling bonds provided therein. Neither the decision nor the opinion has any bearing here.

At the end of this part of its brief, appellee makes the following statement:

"* * * what the Barry case held in effect was that * * * the dissenting bondholders here are required to establish their rights on the basis of a $16,000,000 bond issue."

But as just shown, the *Barry* case does not hold any such thing; indeed it assumes the exact opposite.

SECOND PROPOSITION: PETITIONER IS BARRED FROM OBTAINING A CONFIRMATION OF ITS PROPOSED PLAN BECAUSE OF ITS LACK OF GOOD FAITH AND CONSTRUCTIVE FRAUD.

Appellee suggests that the requirement of good faith is (as against appellee) merely a requirement that the plan be feasible. The numerous authorities under Section 77B are to the contrary (Our Br. pp. 38-41). The require-

ment of good faith appears in substantially the identical context in Section 77B and in the statute here involved.

When the government or a governmental agency seeks relief from a Court, it is subject to the same rules as private litigants.

Luckenback S. S. Co. v. The Thelka, 266 U. S. 328.

Petitioner diverted $717,932.50 of trust funds.

Appellee says that all the money diverted has been accounted for. It is no answer to a charge of diversion of trust funds that the unauthorized uses are shown.

Appellee asserts that sufficient funds are now again in the treasury of the district to satisfy the claims to diverted trust funds (p. 45). The diversion by appellee of the trust funds, the intent that such diversion shall be permanent, and the effect of hindering, delaying and defrauding creditors, are clear from the undisputed evidence (Our Br. p. 45).

Appellee asserts that all the money collected and not spent for necessary "*operations*" is now in the treasury to be placed where the Court orders (Br. p. 45). This is not true. There was spent by the district, during the period 1933 to 1937, inclusive, for *capital betterments, alone,* $321,601.52;* in capital payments (R. 515), on Crocker-Huffman contracts for the purchase of water rights, $299,049.34 (R. 847, 853, 864, 874, 882); irrigation district bond *principal,* $59,000**; *principal* payments on drainage bonds, $61,200 (R. 848, 854, 865, 874, 883); refinancing expenses (*exclusive* of interest paid depositing bondholders), $284,430.82 (R. 847, 854, 865, 875, 882).

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*1933, $32,692.42 (R. 847); 1934, $40,933.48 (R. 853); 1935, $52,392.34 (R. 864); 1936, $80,187.85 (R. 874); 1937, $115,395.43 (R. 882).

**1933, $24,500 (R. 848); 1934, $34,500 (R. 854).

A total of *$966,281.68* was thus spent for capital and refinancing expense, which was not operating expense.

Appellee claims that "each year from 1922/23 to 1931/32, inclusive, after *bond service was satisfied,* the balances of the bond fund levy (delinquency collections, etc.)", were placed in the general fund as expressly authorized by law, and that such transfers occurring *prior* to 1933 account for "all but $320,272.93" of the $717,932.50 (App. Br. 45). Appellee thus claims that this money was legally transferred from the bond fund *before 1933* when the bonds were *not* in default.

This is not true. The undisputed testimony of Mr. Neel, auditor for the district, is that the entire amount of $717,932.50 was collected "as a result of the collections of delinquent taxes *that were delinquent as of December 31, 1932*" (R. 414). Thus, the entire amount was collected *after* December 31, 1932, and *after* the bonds of the district were in default, so that the right to transfer had ceased.

Appellee admits the diversion of $320,272.93 of 1932/33 collections (App. Br. p. 45), but gives as its excuse that under the first refunding plan of 1933, *which never went into effect,* it was proposed that this money be transferred for general purposes of the district. It is no excuse for diversion of trust funds to say that the district would have been entitled to the money if an agreement had been made.

Appellee repeatedly states that the granting of the RFC loan raised the price of the bonds from 18 cents to 50 cents (p. 48). This statement is not defensible. The testimony of Mr. Lester (R. 500) referred to in appellant's brief was that the bonds sold at 18 *at the bottom of the depression,* but *had reached 32 in the fall of 1934,* and it was undisputed that there was a bid of 56 for the

bonds February 5, 1935 (R. 521), eight months before the first disbursement under the RFC loan, in October of 1935 (R. 367). The bonds of overlapping tax lien districts, which have no greater security than have the irrigation district bonds, and which were not "refinanced" by the RFC, and upon which principal and interest has been paid (R. 419, 540), such as Merced Union High School District, have recovered with securities generally, so that they are now selling above par (R. 889). The effect of the RFC loan has been to *limit the price of the bonds to 50.* The passing of the panic, and the inherent value in the district would have raised the price well above that figure.

Appellee (p. 48) claims that refusing to levy taxes for six years for bond purposes was pursuant to law. Even Section 11 of the District Securities Act under which the taxes were levied (Our Br., Appendix), requires the levy of a tax calculated to produce a delinquency of 15%. The actual delinquency produced as of the delinquent date for the year 1937-38 was $23,528.48, or 6.84% as of the last Monday in June, and as of November 1, four months later, was reduced to $12,262.39 (R. 668). Delinquency after one year in each of the levies from 1933 to 1937 as of November 1, 1938, average 1⅓%. Therefore (App. Br. pp. 46, 47), petitioner has not, we submit, complied with the law under which such reduced taxes were levied.

The district misrepresented its financial condition.

The primary basis of our discussion of this point was appellee's own balance sheet (Ex. 26).

The term "balance sheet" is defined in The New Merriam-Webster Dictionary as "A statement of the financial condition of an individual or organization at a given date, esp. a statement of assets, liabilities and net worth". This is the only meaning given to the term, either in the dic-

tionary, or in the works on accounting. The testimony of the district's auditor at the trial was that this exhibit purported to be a true statement of the financial condition of the district, assuming that its indebtedness included the whole bond account (R. 425).

Appellee (App. Br. p. 50) states that "*petitioner did not overstate its liabilities*". In support of this statement, while it cannot avoid the undisputed fact that $824,684.00 paid to RFC as interest, and other interest paid or not due, was still kept as a liability of the district on its balance sheet, appellee attempts to excuse itself by the claim that this interest was carried on the books as an "interest expense account *in the nature of a refinancing charge*".

This is no justification, and further, is not true. Mr. Neel testified that this amount was "paid on bond interest expense" or as "an interest expense account" (R. 425). It is shown in the published financial statements of the district for 1936 and 1937 (R. 875, 883) as "Interest Account, Reconstruction Finance Corporation". As we have shown, the district *charged the same interest twice.* It paid it once out of its cash account, *as an operating expense,* and set it up the *second* time as a *fictitious liability,* although it had already been paid. No amount of adroit general statement can avoid the fact.

It is true as to the overstatement in bond principal, that all parties knew the indebtedness was $16,191,000. However, a separate item of $387,000 additional was set up in a *different* place as a *current* liability, where it was not readily perceivable, and, as stated in Mr. Lombard's affidavit, that amount was charged to surplus. In short, a *fictitious deficit was created* by the charge. Since the *question at issue* was as to whether the district had a *surplus* or *deficit,* and how much, and the direct effect of this maneuver was a *fictitious increase of the deficit,* there

can be no question as to the material falsity of the statement in this respect.

Petitioner contends that it did not understate its assets. It claims that if the assessment levy of $340,000 should be included as an asset, estimated expenditures of 1939 should be included in the balance sheet as a liability. The very definition of the term "balance sheet" in the dictionary discloses the fallacy of this statement. A balance sheet contains only assets, liabilities and net worth as of a given date. *It is not a budget* wherein future expenditures and income are included. The $340,000 was a current, collectible, account receivable, secured by a lien on all of the lands in the district, and constituted an asset. Estimated expenditures for the future did not constitute a liability.

Appellee half admits (App. Br. p. 52) as its secretary did in fact admit (R. 515), that the Crocker-Huffman contracts constituted a capital asset which were not shown as assets but were charged off to operating expense.

Appellee denies that it kept books and records on two separate theories of its liabilities to the RFC. It made reports and *balance sheets* to the RFC showing liabilities of $13,000,000 less than the liabilities set forth in Exhibit 26, a *balance sheet* (Ex. J & K, R. 774, 784). Those balance sheets were approved by the RFC, and the district confirmed the RFC auditors' statements as to the amount of the liability to the RFC shown on the district records (Ex. N, R. 797), writing to the RFC "*the above is in agreement with our records* at December 31, 1936, with the following exceptions * * *." The evidence remains undisputed that the district kept one set of records and *a balance sheet* for the RFC, and it introduced in Court *another balance sheet* and set of records, in which its liabilities were set up as *$13,000,000 greater* (App. Br. p. 56).

THIRD PROPOSITION: PETITIONER HEREIN IS NOT "INSOLVENT OR UNABLE TO MEET ITS DEBTS AS THEY MATURE".

See the discussion of this point in our brief (pp. 53-4). Appellee says (p. 54) that even though appellee owes the RFC only $7,570,000, as we contend, then "presumably",

> "the R.F.C. at any time can demand payment of the entire sum * * *"

This is not true. The RFC's rights are stated in the documents, and the right to demand full payment at any time is not among them.

FOURTH PROPOSITION: THE PLAN OF COMPOSITION IS NOT FAIR, EQUITABLE OR FOR THE BEST INTERESTS OF THE CREDITORS; AND IS DISCRIMINATORY.

We first deal with the law concerning what is a fair plan, with particular reference to *Case v. Los Angeles Lumber Products Co.,* supra.

A. THE APPLICABLE RULES OF LAW CONCERNING WHAT IS A FAIR PLAN.

Preliminarily we deal with appellee's discussion of this and another case.

(a) Luehrmann v. Drainage Dist. No. 7, 104 Fed. (2d) 696.

The appellee relies extensively on the *Luehrmann* case just cited in the heading. We therefore discuss the case rather fully.

1. Appellee says (p. 54) that the denial of certiorari in this case is "highly significant". A sufficient answer is the following quotation from

United States v. Carver, 260 U. S. 482, 490:

> "The denial of a writ of certiorari imparts no expression of opinion upon the merits of the case, as the bar has been told many times."

2. Appellee repeatedly (pp. 19, 29, 37) refers to the *Luehrmann* case as authority for its contention that the RFC is a creditor to the full amount of the old bonds.

The fact is that in the *Luehrmann* case it was *not even contended* that the RFC was a creditor beyond the amount of its loan, it being conceded by all concerned that the RFC's right in the old bonds was simply that of a pledgee. There are three opinions: One by the District Court passing on the constitutionality of the second bankruptcy statute (21 Fed. Supp. 798), the District Court's opinion approving the plan (25 Fed. Supp. 372), and the opinion of the Circuit Court of Appeals (104 Fed. (2d) 696). In its first opinion the District Court said,

> "In this particular case, however, *no agency of the government holds the old securities,* but they are in fact held by a trustee who appears to have taken over legal title from the original bondholders, the larger portion of whom transferred the bonds to the trustee through the agency of the Bondholders' Protective Committee" (21 Fed. Supp. 801, 802).

The terms of the trust spoken of by the Court do not appear, but it does appear unequivocally that the trustee, and not the RFC, was owner of the bonds.

The trial Court, in approving the plan, made a finding reading in part as follows:

> "* * * said bonds are held now as collateral to the note of Louis V. Ritter, Trustee, and are voted in favor of the debt readjustment plan * * *" (104 Fed. (2d) 702).

The Circuit Court of Appeals said on this question:

> "* * * *Chapman, holding as trustee 98.2% of such bonds, filed acceptance of the plan* * * *.
>
> " 'the old outstanding bonds, as well as the judgments purchased from the Cross County claimants are being held by the Federal Reserve Bank in Cleve-

land, *as collateral to the trustee notes.' (Given for the proposed loan and advancements by the Reconstruction Finance Corporation)*'' (104 Fed. (2d) 699, 700).

3. In the *Luehrmann* case both the trial Court and the Circuit Court of Appeals relied on the fact that a large proportion of the bondholders had consented, as being evidence of fairness (25 Fed. Supp. 378, 104 Fed. (2d) 703). This, indeed, is conceded by appellee (App. Br. pp. 64-5).

4. Appellee states, at page 91 of its brief:

> "The issue of *res judicata* also was apparently involved in *Luehrmann v. Drainage Dist No. 7,* 104 Fed. (2d) 696, and resolved against appellants."

There is no foundation for this statement. It nowhere appears that the issue of *res judicata* was in the case; and indeed it could not have been, for the reason that although a proceeding was brought by the district under the first Municipal Bankruptcy Act, that proceeding was *dismissed by the petitioner district,* after the decision of the *Ashton* case (21 F. Supp. at p. 822).

5. In the *Luehrmann* case it is explicitly held that the District there involved (an Arkansas Drainage District) was not a governmental agency (see 104 F. (2d) at p. 698).

(b) Case v. Los Angeles Lumber Products Co., ... U. S. ..., 60 Sup. Ct. 1.

The obvious importance of the case cited in the heading makes it unnecessary for us to analyze the Court's opinion, since the Court has undoubtedly examined that opinion itself.

The appellee seeks to escape from the *Los Angeles Lumber Products Co.* case by arguing that Section 77B is a reorganization statute and the Municipal Bankruptcy

section a composition statute, and that therefore under the latter section the plan need not be found "fair and equitable" within the settled meaning of those words, established long before they were used in this statute (App. Br. pp. 54-59).

This argument need not detain us long. As is well known, the earlier devices for dealing with insolvent enterprises (without compelling dissolution) were (a) the old composition Section 12 of the Bankruptcy Act, and (b) the procedure developed by the Courts without the aid of statute in equity receivership proceedings. Neither was entirely satisfactory, and the Congress undertook to provide adequate statutory procedure: It enacted Section 77 (for railroads), Section 77B (for private corporations), the first Municipal Bankruptcy provision (Section 80), and thereafter the present provision (Sections 81-84). All are developments from, and combine qualities of, the old composition sections and the judicially developed equity receivership; all are substantially identical in their essential requirements. As stated by *Gerdes on Corporate Reorganization,* Vol. 1, p. 95:

> "Section 77B merely applies *the principles of composition,* modified to meet the problems peculiar to enterprises corporately owned."

See the introductory sections in *Gerdes on Corporate Reorganization,* and in *Finletter, Principles of Corporate Reorganizations.*

The words "fair and equitable" appear in the same context in Sections 77, 77B, the first municipal bankruptcy provision, and the section here involved. The *Los Angeles Lumber Products Co.* case says that they are words of art with a fixed legal meaning. The opinion points out explicitly that the "fair and equitable" standard was not present in, or required by, the old composition section 12.

(c) The proposed plan violates the principle of the Boyd case under any theory of the facts.

The principle now established by

Case v. Los Angeles Lumber Products Company, ... U. S. ...., 60 Sup. Ct. 1,

is summarized in the following quotation by the Court from an earlier opinion:

> "In Louisville Trust Co. v. Louisville, New Albany & Chicago Ry. Co., supra, this Court reaffirmed the 'familiar rule' that 'the stockholder's interest in the property is subordinate to the rights of creditors. First, of secured, and then of unsecured, creditors.' And it went on to say that 'any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.' "

This doctrine, we submit, is no mere rule of thumb. On the contrary it is a simple and obvious principle of common honesty.

It is not to be assumed that the Court will be less solicitous to preserve this principle in administering the municipal bankruptcy sections than it is in administering the corporate reorganization sections.

(d) The principle of the Boyd case has two applications.

There are two applications of the principle that a plan is unfair where its effect is that the subordinate rights of the debtor, or the equitable owners of the debtor, are secured at the expense of the prior rights of creditors:

1. Where the property responsible for the debts is worth less than the amount of the debts, then the creditors must be given the *full value* of the property chargeable with the debts; for if they are not, the plan simply takes

property which belongs to the creditor and gives it to the debtor. The *Los Angeles Products* case holds that this is unfair.

2. Where the assets *exceed* the amount of the debts, then, for the same reason, no plan is fair whereby the creditor is compelled to take less than the amount of his claim. This necessarily follows from the same principle. Thus, in the case of

> *In re Day & Meyer, Murray & Young,* 93 Fed. (2d) 657,

the Court said, in part:

> "Where the value of the mortgaged property is more than the principal amount of the bond indebtedness, there is no justification in reducing the indebtedness to one-half of the principal."
>
> * * * * * * *
>
> "It is the duty of the court to scrutinize the plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not by indirection diverted to stockholders. In re New York Rys. Corp., 2 Cir. 82 F. 2d 739; In re Barclay Park Corp., supra."

(e) The relation between the petitioner, the land, the landowners, and the debt.

The landowners are the owners of the debtor.

Although the landowners in an irrigation district are not shareholders, they are in substantially the same position as shareholders, being the equitable owners of the debtor. Thus, in *Hall v. Superior Court,* 198 Cal. 373, it was held that certain judges, who were the owners of land in an irrigation district, were disqualified in an action against a private water company for damages caused by seepage of water from a canal, where the irrigation district had a proprietary interest in the canal. The Court said in part:

"*While not occupying the precise status of stockholders in a corporation, yet the land owners, as members of an irrigation district, sustain such a relation to the district as to give them a proprietary interest in the district's property.* This relation is aptly pointed out in the case of *Merchants' Nat. Bank v. Escondido Irr. Dist.*, 144 Cal. 329, 334 (77 Pac. 937, 939). * * *

"[The statute vests in the landowners] a definite proportion of the water of the district, and in all, in common, the equitable ownership of its water-rights, reservoirs, ditches, and property generally, as the means of supplying water. (Stats. 1887, pp. 34, 35, secs. 11, 13.) *Such rights as these cannot be distinguished in any way from other private rights,* * * *".

See, also:

Hershey v. Cole, 130 Cal. App. 683;

Lindsay-Strathmore Irrigation District v. Wutchumna Water Co., 111 Cal. App. 688.

The land is charged with payment of the debt.

Any number of cases make it clear that these bonds are in practical effect the equivalent of (and indeed superior to), a mortgaging of the lands of the district as security for their payment. Thus, in

Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365, 373-4,

the Court said of irrigation district bonds,

"In our opinion, the statute was intended to secure the bonds by the proceeds of the land in the district. It is true that the bonds themselves are not a lien on the land. But the assessment is a lien (sec. 40), and the district is required to collect the assessment or sell the land."

Again, in

Moody v. Provident Irrigation Dist., 12 Cal. (2d) 389,

the Court quoted and relied on an earlier case concerning municipal bonds, to the effect that they are "equivalent to a trust deed".

The fundamental principle of the Boyd case is the law of California Irrigation Districts.

There is no doubt that the law controlling California irrigation districts includes, in essence, the very principle of the *Boyd* case. Thus, in

Provident Land Corp. v. Zumwalt, supra,

the Court said (12 Cal. (2d) 370, 371, 372, 375-6):

> "The ordinary method of payment of bondholders is clearly indicated by these provisions. The directors must levy assessments in a sufficient amount to meet principal and interest payments."

The Court then referred to the depression of the early '30s, and said:

> "As a result, some districts now own practically all the land within their boundaries, * * * The delinquencies have gone too far in this and other districts to save the landowners. * * * In our opinion, the statute was intended to secure the bonds by the proceeds of the land in the district. It is true that the bonds themselves are not a lien on the land. But the assessment is a lien (sec. 40), and the district is required to collect the assessment or sell the land. * * *
>
> Evading creditors is not a contemplated activity of a public district, whose bonds are recognized investments for financial institutions. Among other purposes of the act, therefore, is the repayment of the bondholders of the district, and it follows that this is one of the purposes for which the trust money is held.
>
> This view is fortified by a consideration of the general plan of the statute, in so far as it provides for the creation of an obligation and a procedure for payment. The land is the ultimate and only source of payment of the bonds. * * * Any practice which re-

> moves the land from its position as ultimate security for the bonds, or which places its proceeds beyond the reach of the bondholders, destroys that plan and is contrary to the spirit of the act."

The foregoing discussion demonstrates, we submit, that in every essential respect the situation created by the issuance of irrigation district bonds is precisely that contemplated by the principle of the *Boyd* case.

(f) Municipal bankruptcy is a cooperative venture between the State and Federal authorities.

It is important to observe that the second Municipal Bankruptcy Act requires cooperative action by both the Federal Government and the States. As stated at numerous points in the Municipal Bankruptcy Act, the Federal Courts in administering the Act must be careful not to encroach in any way upon the sovereign powers of the states; and under the Bekins decision this is not merely a statutory requirement but a constitutional requirement. The cooperative nature of municipal bankruptcy is referred to three times in the Court's opinion (304 U. S. 27, 53-4).

Obviously, the State's part of the enterprise includes provision of means for compliance with the principles of the federal statute, including the principle of the *Boyd* case.

It cannot be said that the State, or an agency of the State, can confront the Federal Courts with a plan which violates principles of bankruptcy, and insist upon its approval.

(g) The value of the assessable lands of this petitioner far exceed the amount of its debts.

As shown at length in our opening brief, the conservative value of the privately owned lands in the district (at least $50,000,000), is two and one-half times the total amount of the district's debts, even assuming that its whole bond issue is still owing (Our Brief, pp. 64-66). Appellee does not dispute this.

These figures ignore the property owned by the district itself, and ignore the fact (also shown in our opening brief), that the district's power revenues alone will amortize and extinguish nearly half of the district's total debts, even on its own theory. It follows that in actual fact, the conservative value of the privately owned lands in the district is from four to five times the amount of debts which they must be looked to to pay, even assuming, with appellee, that the whole bond issue is still owing (our brief, pp. 66-71).

The situation confronting this Court may, therefore, be summarized as follows:

This petitioner borrowed $16,190,000 and issued bonds therefor. Largely with the bondholders' money it acquired assets, the present value of which, as shown by its own records, exceeds $20,000,000 (our brief, p. 64). As security for the moneys borrowed, its contract with the bondholders encumbered the lands of the district, consisting of 189,000 acres, the present value of which (largely attributable to the bondholders' money) exceeds $50,000,000.

In these circumstances, then, with corporate assets of over $20,000,000, with lands chargeable for its debts worth at least $50,000,000, with power revenue sufficient to amortize and discharge nearly half of its total debt on its own theory, the petitioner now tells the Court that it should be permitted to repudiate half the principal amount of its

debt, and the whole (as to appellants) of six years of delinquent interest.

A more striking violation of the rule of common honesty laid down by the Supreme Court could hardly be imagined.

B. THE FACTS CONCERNING FAIRNESS OF THE PLAN.

The first point is this: that in legal effect *there is no finding that the plan is fair.*

(a) The issue of fairness is at large: This because the trial Court's finding is based on Irrelevant Facts.

The trial Court found, simply in the language of the statute:

> "That the plan of composition as offered by the petitioner herein is fair, equitable and for the best interests of its creditors * * *" (R. 214).

But the Court's opinion discloses that this finding is based in large part on the proposition that the major proportion of creditors consented to the plan. The opinion below reads in part:

> "We consider as most forceful, irrefutable evidence of the fairness of the plan the indisputable fact that more than 90 per cent. of the invested capital in the bonds of the District has taken advantage of it. The legal requirement of debt composition under Chapter IX of the Bankruptcy Act has been exceeded by nearly 25 per cent. of the affected invested capital."

As the Court said in *Case v. Los Angeles Lumber Products Co.*, ... U. S. ...., 60 S. C. 1:

> "Hence, in this case the fact that 92.81% in amount of the bonds, 99.75% of the Class A stock, and 90% of the Class B stock have approved the plan is as immaterial on the basic issue of its fairness as is the

fact that petitioners own only $18,500 face amount of a large bond issue."

See the trial Court's entire discussion of this point, Record, pages 175-6.

It is settled that such a finding will not sustain a decree; on appeal, the Court either orders a new trial or itself examines the evidence, makes a finding one way or the other, and affirms or reverses accordingly. Thus, in the case of

In re Welsh, 5 F. (2d) 918,

it was held that although both the Referee in Bankruptcy and the District Court had concurred in a finding, it would not be accepted on appeal because it appeared that the Referee and the Court below took account of evidence which should not have been considered on the question.

See, also, for example, *Saari v. Wells Fargo Express Co.,* 109 Wash. 415, 186 Pac. 898, where the Court said:

> "In cases tried by the court, we ordinarily consider that improper and incompetent evidence is given no prejudicial weight or credence, but here the contrary affirmatively appears. The report of Benjamin to the police department was improperly admitted, and was given undue weight and improper analysis by the trial court."

Metropolitan State Bank v. McNutt, 73 Colo. 291, 215 Pac. 151:

> "The general rule that it is presumed that the court considered only competent evidence cannot be applied here, because it is shown by the bill of exceptions that the court rested its conclusions on evidence which is not competent on the issue in question."

In the present case, therefore, the trial Court's finding cannot stand; and the question whether the plan is or is not fair is at large. We have shown at length that it is not, and supplement that discussion below.

(b) The question of fairness is independent of the question how much the District owes.

Obviously the question whether the proposed plan is fair is wholly independent of the question how much the District owes. Much of appellee's argument resolves itself into the argument in substance that (a) Appellee needs relief; (b) Therefore the plan is fair.

(c) Petitioner has not shown that its plan is fair.

We now discuss the important items of evidence put forward in appellee's brief to support its contention that the plan is fair.

The Giannini Foundation, or Benedict, Report, and the testimony of Dr. Benedict at the former trial, do not show that the district is now unable to pay its debts.

Appellee's brief contains numerous statements to the effect that the Benedict, or Giannini Foundation, Report, shows that the petitioner district is so insolvent as to require the adoption of the petitioner's plan of composition (Br. Appellee pp. 6, 61). There is no justification for this statement. The report was originally the basis for the first refunding plan, wherein the district agreed in 1933 to refund the indebtedness of the district for the principal amount of $16,191,000 in 50 year sinking fund bonds, with interest at 4% and 4.4% (Ex. OO, pp. 90, 91). That such a plan was justified we may agree, but that the report gives any basis for the repudiation of the major portion of the district's indebtedness proposed in the current plan is not true.

The Giannini Foundation Report (Ex. 35) and the testimony of Dr. Benedict at the former trial (R. 432-471

incl.) relate only to the 3 year period 1929-31 (Ex. 35, p. 23) (R. 435) (*not,* except as to a supplemental study of 26 admittedly non-typical large corporate operations (Ex. 35, pp. 19, 64), for *six* years, as appellee states (Br. Appellee p. 5). This was a panic period admittedly not typical (R. 451), the end of which was *nearly 7 years prior to the trial of the case below.*

The report therefore is of little value on the question of present ability to pay.

In the meantime there have been many substantial changes. Testifying in April of 1936, at the former trial, Dr. Benedict stated "it is true, I think, that costs are being somewhat reduced from what they were in the period when this survey was made" (R. 471). The agricultural price index stood at *87* in 1931, 70 in 1933, and *121* in 1937 (Br. Appellee, App. A), showing a marked rise in agricultural prices at the same time that costs were dropping, so that the net result of operations, which Dr. Benedict considers the essential question (R. 456) was very much better at the time of the trial than it was in 1931.

The Giannini Foundation Report was prepared on the assumption that the $4,500,000 in mortgages (Ex. 35, p. 109) ought not to be scaled down in any reorganization (R. 458-459). It was also prepared upon the assumption that the debt should be such as could be carried by the large land owners (R. 470). These include large corporate enterprises for colonization of the land, as well as corporations operating foreclosed lands (Ex. 35, p. 64), such as California Lands, Inc., a Trans-America subsidiary (R. 473).

The report is not a study of the ability of the district as a *whole* to pay taxes, or of the average within the district, but only of certain of the poorer lands. Of the total assessment levied for the year 1930-31 ($1,194,-

585.35), there was first *eliminated* from consideration in the survey the city lands, having an assessment of $132,219.85, and rural properties of less than 20 acres, and land not sampled, of $605,619.99, or a total of *$740,924.39, or 61% of the assessed value.* There was *included* in the studies *only samples* from properties having an assessed value of *$456,745.51 (Ex. 35, p. 103), or 39% of the total assessed value.*

That the samples studied were from the poorer situations in the district is demonstrated by a comparison of the total tax delinquency for the entire district in 1931, of 17.63% (Ex. 35, p. 103), totaling $210,596.89 (R. 667) with the delinquencies of $199,731.32, or 43.73% for the lands sampled in the survey. This leaves $10,865.57 or *1.4%* as the *delinquency,* of the property *not included* in the survey, having an assessed value of $740,924.39, as against a *delinquency* of 43.73% for the lands *included* in the survey (Ex. 35, p. 103), having an assessed value of $456,745.51.

While the record does not disclose which of the properties sampled, including 1638 farms over 20 acres in size, were the ones substantially delinquent, it does appear that delinquencies were very much heavier for the large corporate properties (R. 470), and that individuals operating family size farms are much more efficient than large corporate and individual operators (Ex. 35, p. 64). These facts, coupled with the low (1.4%) delinquency on the farms under 20 acres, suggest that the major delinquency was in 39 large holdings comprising 64,000 acres (R. 681) in the district, including Trans-America holdings of 6000 acres (R. 473), and that the owner-operated farms were earning sufficient to pay their taxes, even in the depths of the depression.

The farms covered by the report are limited to 150 farms out of 2800 in the district, being the middle 50%

of 300 farms selected by lot out of 1600 farms in the district (R. 470) (Ex. 35, p. 23) (R. 467). In these 150 cases, investigators went to the farmers and in "one sitting" (Ex. 35, p. 23) elicited such information as they could, based on the *farmer's remembrance* of his transactions during the preceding 3 year period (Ex. 35, p. 24). It is admitted in the report that the records thus secured will be "subject to some little error", and that "the incentives for biased replies are greater in the present case than in ordinary farm management studies" (Ex. 35, p. 24).

The results achieved in the study of deciduous fruits, for example (R. 435, pp. 32 to 37), indicating a very large variation in results and a rather low profit or loss, are in marked contrast to results obtained by the University of California in one of the same years by carefully kept records of the operation of peach orchards in Stanislaus County, where, in the year 1929, the University of California study, based on accurate records, shows a *per acre net profit of $467.50* (Ex. 35, App. H, p. 95, and Table 9 of App. H, p. 102).

It is apparent on the face of some of the tables that cost allowances for family labor are, in many cases, fictitious, and create the *illusion* of a loss on operations, where, *in fact,* a *profit* was made. While space does not permit us to point out the numerous examples of such obvious fictitious family labor charges, we call attention, as an example, to Schedule No. 244 in Table 29 (Ex. 35, p. 51), showing a net loss of $42.40 per acre. Table 27 (Ex. 35, p. 49) shows that on this same ranch (Schedule 244) there was a total labor charge of $105 per acre, of which $7.50 was hired, and *$97.50* was *family labor.* There are a number of farms shown in Table 27 where all of the labor was hired, but the *most* paid on any farm where *all* of the labor was hired was *$39.51* (Schedule 320, Table

27, Ex. 35, p. 51). It is a fair inference that the family labor has been over-valued by $65, in Schedule 244. Reducing the cost charged on Schedule 244 by the $65 per acre overcharge, shows a *profit* of $23 per acre instead of the *loss* of $42.40 per acre. An examination reveals similar discrepancies throughout all of the tables; and we believe it is a fair statement to say that the elimination of *fictitious labor charges for family labor alone* results in showing a rather substantial profit on the average, for the farms studied in the Giannini Foundation Report.

The Court will also note that in Tables 8, 9, 10, 14, 15, 16, 21, 19, 22, 25, 27, 28, 32, 33, 34, 38, 39, 40 and 43 of the Giannini Foundation Report (Ex. 35), showing costs of operation of specific farms, the *higest cost* per acre ranges from *10 to 40 times* the *lowest cost* per acre for the *same type of crops,* on the *same type of lands,* on farms of *similar acreage.* This variation alone is so contrary to the probabilities as to suggest that the study cannot be relied upon.

The report contains studies of large corporate organizations during the period 1926-27-28, showing, as Dr. Benedict put it, "rather heavy losses" in those years, when they operated directly (R. 438). That these operations are not typical is demonstrated by the fact that when the same lands were rented to individual operators, they received a small net return, even in those years of panic conditions (R. 439). The report admits they were not typical (Ex. 35, p. 64, p. 19): The owners, being banks and colonization companies, were essentially speculators, not operators (Ex. 35, p. 64).

Nowhere in the Giannini Foundation Report, or in the testimony of Dr. Benedict, is the opinion expressed as to what amount the district could and can pay, even as of that time. As above stated, the report was originally the

basis for a refunding plan for payment of *the entire principal amount* of the indebtedness (Ex. OO, p. 90).

The testimony of Mr. Momberg does not show that the district is unable to pay its debts, but tends to prove the contrary.

Appellee states (Appellee Br. p. 6) that the testimony of Mr. Momberg shows the same situation that Dr. Benedict had found, and that the lands of the district are not now operating at a profit (Appellee Br. p. 61). Both of these statements are unsound. Mr. Momberg testified only concerning lands taken over on foreclosure by the Bank of America and affiliates. Dr. Benedict testified (R. 438), and the Giannini report showed (Ex. 35, p. 64) that this type of corporate enterprise was much less efficient than the owner operated farms comprising the bulk of the district, and were losing (R. 438) in the period 1929-31. The operation of California Lands, Incorporated, was therefore not a typical operation but a bad one. However, contrary to the statement in appellee's brief, the testimony of Mr. Momberg was to the effect that California Lands, Incorporated, was making a *profit*—not losing money in the period from 1935-38 (R. 488, 489). Mr. Momberg did not testify as to his opinion of the fairness of the plan or as to the results of operation of the average farm. He did testify that the lands which he managed were average for the district (R. 49), that 67 sales had been made (R. 489), that the average sales price for the property which the company now holds is $135 per acre (R. 485), that although properties were operated at a loss in 1932 (R. 481), the net result of operating all properties in the years 1935-38, inclusive, showed a profit (R. 488, 489), that average operating expenses were $27 per acre, that the $3 per hundred tax rate amounted to $1.75 per acre, and that this represented only 5% or 6% of the operating cost of the farms (R. 494).

There is no evidence in the record that the RFC refused to lend any more money, as claimed by appellee (Appellee's Br. p. 61).

Since the district did not place in evidence any of the appraisals or even the application for the loan made to the RFC, the inference is that the appraisal was favorable to a greater loan. Presumably the RFC followed the statute (43 U. S. C. 403) which says that before making a loan the RFC must be satisfied that the borrower will be able to get in "a major portion" of its bonds at "the average market price of such bonds over the six months period ending March 1, 1933", i. e., at panic prices.

The amount of the RFC loan is therefore no evidence concerning the ability of the district to pay.

Appellee's statement (p. 61), that "The R.F.C. concluded the District could not carry a greater loan than the plan provides for" is therefore (to put it mildly), unsupported by the record.

(d) The actual net income of petitioner during the last three years (deducting abnormal power revenue) would service a bond issue of nearly $14,000,000. It offers $8,-500,000.

As noted above, the value of the lands in the district is conservatively two and one-half times the amount of its debts, which are a *first charge upon those lands.* We now discuss the income-producing capacity of the district, i. e., its ability to pay its debts *without recourse to the security.*

We stated in our opening brief that, despite the fact that the petitioner district has levied an extremely low tax of $1.75 (R. 490) or $1.80 (R. 517) per acre, entitling the landowners to 4 acre feet per annum per acre, the cash on hand in the district treasury increased from $346,-313.61 on December 31, 1934 (R. 852) to $1,578,446.14 on

November 1, 1938, a *gain* of *$1,232,132.53* in three years and ten months. In answer thereto, in several places in appellee's brief (pp. 62, 71), appellee has stated that this was entirely due to a "providential" power yield. An analysis of the income and expenditures of the district proves that this is not true.

Since the data for 1938 is not complete, we shall consider the years 1935, 1936 and 1937. The actual power revenue and total revenue received by the district in those three years was:

Year	Power Revenue	Total Revenue	References
1935	$ 551,047.22	$1,037,025.07	(R. 863)
1936	584,429.64	1,194,075.78	(R. 873)
1937	602,008.94	1,137,342.72	(R. 881)
	$1,737,485.80	$3,368,443.57	

The undisputed evidence, from the studies made for appellee by Thebot, Starr & Anderton, Inc., Consulting Electrical Engineers (Ex. OO, p. 105), the reports made to the RFC by appellee district (Ex. OO, p. 105, and R. 783), report of appellee to the District Securities Commission for 1936 (R. 729), and the testimony of appellants' witnesses Heinz (R. 894) and Louis C. Hill (R. 534) is that the average annual income from power revenue for the district is $500,000 or more. The excess power revenue over the normal amount of $1,500,000 for the three-year period 1935 to 1937, inclusive, was, therefore, *only* $237,-485.80. Subtracting the amount of power revenue in excess of normal ($237,485.80) from the actual revenue received by the district during the three years ($3,368,443.57), gives us normal gross revenue for the district, after eliminating the above normal power revenue, of *$3,130,957.77.*

During this period, the actual expenses for maintenance, operation, general overhead and capital betterments was as follows:

Year	Capital Betterments	Maintenance, Operation and General Overhead	Total Normal Expense and Capital Betterments	Reference
1935	$ 52,392.34	$276,550.25	$ 328,942.59	(R. 864/5)
1936	80,187.85	318,102.70	398,290.55	(R. 873/5, inc.)
1937	115,395.43	360,784.73	476,180.16	(R. 881/3)
Total	$247,975.62	$955,437.68	$1,203,413.30	

Total annual average expense and betterments $401,134.43[1]

There would thus be available for bond service in a three-year period of average power revenue, the difference between the corrected normal gross revenue of $3,130,-957.77[2], based on actual tax collections, rentals, etc., and normal power revenue, and the actual expenses of $1,203,-413.30, or a total normal net revenue for the three-year period of $1,927,544.47.[3] This amounts to *$642,514.62* per annum net income or surplus available for bond service.

1. This compares with average annual expense for capital betterments and maintenance, operation and overhead (excluding Crocker-Huffman contracts) for the two year period 1931-32, of *$287,605* (calculated from data at R. 693).

2. Collections from delinquent taxes during the period in question, being $396,066.85 (R. 863, 873, 881), or an average of $132.022.28 per annum, were probably about $100,000 per annum in excess of normal. To maintain tax collections at the same rate as collections for 1935-37, therefore, the tax rate would be increased in future years by enough to raise this $100,000, which, on the basis of $320,000 collections from a rate of $1.75 *per acre* (R. 490, 667) would require an increased levy of about 55¢ additional *per acre*, making the future rate, to maintain these tax collections, about $2.30 per acre.

3. This balance of the revenue for the three-year period 1935-37 ($1,927,544.47) would all normally be available in future for debt service. It is accounted for as follows:

Increase cash on hand from December 31, 1934 ($346,313.61, R. 852) to December 31, 1937 ($1,136,498.01, R. 880)	$ 790,184.40
Crocker-Huffman contract payments (capital expenditures which terminate July 1, 1941 (Ex. OO. p. 134)	201,932.81
Principal of drainage bonds (capital expenditures, last maturity, payable 1939, Ex. OO, p. 137)	31,800.00
Non-recurring items, i. e., Refinancing expense exclusive of interest paid depositing bondholders, 1935-37	213,403.65
Loss on Bank Deposit	74,724.47
Interest paid R. F. C. and depositing bondholders	843,259.06
Interest paid on drainage bonds and on old Irrigation District bonds	9,724.78
(from data, R. 864-5, 873-5, 881-3)	$2.165,029.17
Less power revenue in excess of normal, as calculated above	237,485.80
	$1,927,543.37
To balance	1.10
AVAILABLE FOR BOND SERVICE	$1,927,544.47

This normal average annual net income ($642,514.62) *is sufficient to pay principal and interest on a 50-year bond issue (such as was proposed in the first plan), bearing interest at 4%, of over $13,800,000.*[4]

The district's proposed plan provides for a 4%, 33-year issue of $8,250,000 to retire district bonds ($350,000 additional to retire Crocker-Huffman contracts will not be used (R. 511)). The actual experience of the three-year period 1935-37, *adjusted to eliminate excess of power revenues over normal,* with maintenance, operations and capital expense considerably higher than previously (R. 693), demonstrates conclusively that the district *can without any difficulty pay $5,500,000 more than is proposed in its plan, without increasing its collections from taxes.*

Thus the actual experience of the appellee during the last three full years demonstrates the grossly unfair nature of its plan. It operated during those three years under an assessment rate so absurdly low as to produce a rate of delinquency after one year of only 1⅓%, which is plainly less than the normal rate of delinquency in the best of taxing districts in normal times. But notwithstanding that fact, the income of the district (ignoring abnor-

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4. TABLE OF ANNUAL AMOUNT NECESSARY TO RETIRE BOND ISSUE OVER 50-YEAR PERIOD, WHEN PRINCIPAL AND INTEREST ARE PAID SEMI-ANNUALLY:

Interest Rate	$20,000,000 Bond Issue	$15,000,000 Bond Issue	$10,000,000 Bond Issue
3%	$ 774,831.00	$581,123.00	$387,415.00
4%	928,108.00	696.081.00	464,054.00
5%	1,092,475.00	819,356.00	546,238.00

TABLE OF ANNUAL AMOUNT NECESSARY TO RETIRE BOND ISSUE OVER 30-YEAR PERIOD, WHEN PRINCIPAL AND INTEREST ARE PAID SEMI-ANNUALLY:

Interest Rate	$20,000,000 Bond Issue	$15,000,000 Bond Issue	$10,000,000 Bond Issue
3%	$1,013,736.00	$760,802.00	$506,868.00
4%	1,150,720.00	852,040.00	575,360.00
5%	1,294,136.00	970,602.00	647,068.00

mal power revenues), was sufficient to service a debt, set up precisely as in its plan, many millions of dollars greater than it offers to pay.

(e) Merced Irrigation District can, without difficulty, pay annual bond service on a $20,000,000 debt.

The average annual power income of the district is $500,000 (Ex. OO, p. 105; R. 783, 729, 894, 534). Average annual collections from land rentals, water tolls, normal collections of delinquent taxes (excluding annual extraordinary collections of about $100,000), interest, and miscellaneous revenue, as shown during the period 1935-37 (R. 863, 873, 881), exclusive of current taxes, are about $120,-000. The total normal annual revenue other than current taxes is, thus, $620,000. Average annual expenses, for capital betterments, maintenance and operation, and overhead, based on actual expenditures during the period 1935-37, are $400,000 per annum (supra). The annual income available for debt service, before the levy of current taxes is, therefore, $220,000.

We can calculate the amount which can be produced by a levy on the land on the basis of experience. During the past three years, when, according to the testimony of Mr. Sargent, the average assessed value of an acre of land was $60, and the tax rate was $3 per hundred, the levy was *$1.80 per acre,* or according to Mr. Momberg, who testified that he managed average lands in the district, *$1.75 per acre* (R. 490). Exhibit 25 (R. 667) shows that collections for the year 1937-38, to the last Monday in June of 1938, were $320,516.17 (R. 667). It is a simple calculation to determine that if a rate of $1.75 per acre will produce $320,000, a levy of $1 per acre will produce $183,000, a levy of $2 per acre will produce $366,000, a levy of $3 per acre will produce $548,000, a levy of $4 per acre will produce $731,000, a levy of $5 per acre

will produce $915,000, and a levy of $6 per acre will produce $1,100,000. In order to ascertain the amount available for bond retirement, it is only necessary to add to these sums the $220,000 net revenue left from other income of the district after paying its current expenses and capital betterments. Adding the $220,000 thus available, it appears that a levy of:

$1.00	per	acre	will	produce	annually	for	bond service	$403,000.00,
2.00	"	"	"	"	"	"	"	586,000.00,
3.00	"	"	"	"	"	"	"	768,000.00,
4.00	"	"	"	"	"	"	"	951,000.00,
5.00	"	"	"	"	"	"	"	1,135,000.00,
6.00	"	"	"	"	"	"	"	1,320,000.00.

A reference to the table in the footnote (supra) shows what amounts of bond issue at the interest rates shown can be retired by these payments. A *$6 per acre* rate will retire *$20,000,000* in bonds bearing *5%* interest over a thirty year period. A *$5 per acre* rate will retire a *$20,000,000, 5%* bond issue over a fifty year period, and a *$4 per acre* rate will retire a *4%, $20,000,000* bond issue over a fifty year period. Since the improvements paid for by the bond issue will far outlast a fifty year period from today, and the district once approved such an issue (Ex. OO, p. 90), we think an issue of that maturity proper.

This brings us to the question as to what a proper rate per acre would be.

Reference to the record in the case of Palo Verde Irrigation District now before the Court will disclose that in that district the average acre of land actually pays from $5.50 to $6 per acre in irrigation district charges (*Jordan, et al. v. Palo Verde Irrigation District,* Case No. 9133, U. S. C. C. A., 9th Cir., R. pp. 288, 321, 322, 312). The record in that case discloses that that district has a much higher percentage of unimproved alkali and worthless land than has the Merced Irrigation District. It also will show

that that district is limited in its productivity to alfalfa, cotton, cattle and grains (Palo Verde Rec. p. 314). The record in this case shows intensive cultivation in Merced District. Sixty-one per cent of the total assessed value in the Merced Irrigation District is contained in the cities within the district, and in 1100 farms of under 20 acres each (Ex. 35, p. 103). A large area in Merced District is planted to various types of fruit trees and vineyards. The rest of the land is suitable, for the most part, for the crops raised in the Palo Verde Irrigation District (Ex. 35). Costs are higher in the Palo Verde Irrigation District for farming and for transportation, because of its distance from market (Palo Verde R. p. 314). Merced Irrigation District is very fortunately situated geographically.

Water costs, even for field crops, ranging up to $20 an acre, in places in Southern California and in the lower San Joaquin Valley, are matters of common knowledge (Ex. OO, p. 145).

If Palo Verde Irrigation District can pay $6 per acre, certainly Merced Irrigation District, with its superior advantages, can also do so. But if Merced pays only $6 per acre, it can pay all of its normal costs of betterments, maintenance, operation and overhead, and *still service and retire a $20,000,000, 5% bond issue in thirty years.*

The increased development of the district is insurance against recurrence of past financial problems.

Appellee did, as it claims, unquestionably have serious financial problems during the years prior to 1934. Probably the greatest problem arose from the fact that the period, just as the district was getting started, and while it was still being colonized, turned out to be the driest period in the recorded history of the area. This had the

two-fold effect of reducing power revenue substantially for that limited period, and somewhat impairing water supply for irrigation purposes. The period was also the period of the most serious agricultural and business panic in the history of the United States.

But in the three-year period, 1935 to 1937, inclusive, there was a $237,000 excess of power revenue, and in 1938 an excess of over $200,000 of power revenue. At the same time, the index of agricultural prices rose from a low in 1932 of 65 to a high in 1937 of 121 (App. Br. Appendix), while even in April, 1936, Dr. Benedict noted a decrease in agricultural costs. The enormous increase in efficiency of farm machinery during the past five-year period, and the tremendous saving of cost as a result, are matters of common knowledge.

As of the date of the trial, the selling price of the representative lands (R. 492) held by California Lands, Inc., averaged $135 per acre (R. 485), sixty-seven sales had been made (R. 489), and nearly all sales were made on installments (R. 489), so that the payments which had to be earned from the land must average between $15 and $20 per annum, principal and interest, depending on the length of time the purchase contracts ran.

There is a tremendous demand for agricultural lands at a reasonable price. The report of the Governor's Commission on Reemployment of the State of California, made September 30, 1939, says (p. 28), "The most casual survey reveals that thousands of farmers with farm experience are unable to buy or rent land. At the same time, large scale farming is more prevalent in California than in any other state".

Thirty-nine owners in Merced Irrigation District hold over one-third of the land in the district (R. 681). A very

small percentage of the area of land in the district (1100 farms under 20 acres and the cities) sustains 61% of the assessed value of the district. With the tremendous demand which exists for small farms, and the large amount of land available for subdivision in the district, it is reasonable to expect a great increase in the intensification of agriculture within the district. With continued development and stability, many of the problems of the past will be, or have been, solved.

The solution to the problem of uneven power revenue is a fixed maturity bond issue with flexible sinking fund requirements.

The remaining problem of variation of power revenue was considered in the refunding plan of 1933, and was very satisfactorily solved in that plan (Ex. OO, p. 91). The arrangement in that plan was that all of the bonds should have a fixed 50-year maturity, that part of the bonds should bear 4% interest and part of the bonds 4.1% interest, and that the district should set up a sinking fund to purchase bonds in accordance with its revenue. Thus, in periods of subnormal power revenue it would retire an excess amount of bonds and less, or none, when power revenues were low.

This is the answer to the lean and fat cycles in the revenue of the district, rather than the unnecessary repudiation of bonds, proposed in the district's current plan.

FIFTH PROPOSITION: THE CLAIMS WERE IMPROPERLY CLASSIFIED AS BEING ALL OF THE SAME CLASS.

See our brief (pp. 74-76), and brief of Florence Moore (pp. 26-32). One point there emphasized is this:

By Section 83(b) of the Bankruptcy Act:

> "The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute *a separate class or classes of creditors.*"

By the contract between petitioner and RFC, the petitioner pledged the revenues to be received from power,

> "in each calendar year commencing January 1, 1936 except the first $100,000 thereof and except any amount in excess of $575,000 in each such calendar year * * *"

The petitioner agreed that,

> "such allocation shall be irrevocable" (R. 209, 210).

Thus, in the language of the statute, RFC is "the holder of a claim for the payment of which specific property or revenues are pledged".

This one point, we respectfully submit, concludes the case.

Appellee's only attempt to meet it is the following statement:

> "If refinancing is never consummated and the R.F.C. does not take the refunding bonds obviously the set up of the reserve funds and the allocation of the power is nullified."

This is nonsense. In the first place we have shown that the contract now existing between the RFC and appellee is an unconditional loan. Moreover, there is no shadow of a basis for contending that the RFC's exaction of this security is conditional upon getting in all the old bonds.

SIXTH PROPOSITION: THE DECREE UNLAWFULLY TAKES TRUST FUNDS AND VESTED RIGHTS BELONGING TO APPELLANTS.

Appellee begs the question. It says the very object of the bankruptcy laws "is the equitable distribution of the debtor's assets among his creditors" (Br. Appellee, p. 81).

As a general principle of bankruptcy law, it is of course true that the purpose is an equitable distribution of *unencumbered* assets *among general creditors.* But bankruptcy has never gone to the lengths of taking property belonging to a *creditor* and giving it to the *debtor.* Appellee fails entirely to meet the proposition that the bondholders *are not merely creditors.* They are the *equitable owners* of the assets of the district.

The proposition here is that the actual equitable ownership of the bondholders is taken from them—not merely that their contracts are impaired. Bankruptcy may impair a contract but it may not confiscate property, and that is what appellee seeks to do here (see Our Brief p. 77). We refer also to the discussion in brief of appellants in the case of *Moody et al. v. James Irr. Dist.,* No. 9353, now before this Court, particularly pages 74-89.

ON THE REMAINING POINTS WE REFER TO OUR OPENING BRIEF.

Lack of space prevents reply to appellee's treatment of the remaining points in our opening brief. We therefore refer on these matters to our opening brief, except as to our Ninth Proposition, which is that it is *res judicata* between the parties that the Constitution forbids the granting of the relief sought. The separate reply brief of Mary

Morris, filed herein by Mr. George Clark, replies fully to appellee's discussion of this point.

Dated, San Francisco, California,
December 26, 1939.

Respectfully submitted,

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